

**Improvements to the Office of Chief Counsel's
Published Guidance Process Would Enhance
Guidance Provided to Taxpayers and the
Internal Revenue Service**

March 2003

Reference Number: 2003-10-081

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

March 31, 2003

MEMORANDUM FOR CHIEF COUNSEL

Gordon C. Milbourn III

FROM: Gordon C. Milbourn III
Acting Deputy Inspector General for Audit

SUBJECT: Final Audit Report - Improvements to the Office of Chief Counsel's Published Guidance Process Would Enhance Guidance Provided to Taxpayers and the Internal Revenue Service (Audit # 200210005)

This report presents the results of our review of the Office of Chief Counsel's published guidance process. The overall objectives of this review were to determine whether the Office of Chief Counsel's published guidance¹ process effectively prioritizes tax issues and whether management effectively monitors published guidance projects to provide taxpayers and the Internal Revenue Service (IRS) with timely service. Through the published guidance process, the IRS and the Department of the Treasury's Office of Tax Policy issue regulations and other guidance to interpret and explain the Internal Revenue Code. Published guidance promotes a uniform understanding and consistent application of the tax laws by taxpayers and the IRS.

In summary, the Office of Chief Counsel needs to improve its processes for prioritizing and tracking tax issues being considered for the published guidance plan. In addition, the Office of Chief Counsel needs an effective process to document both the criteria for selecting the tax issues for publication and the impact of selected tax issues. Since resources are limited within the Office of Chief Counsel, it needs to ensure that it is focusing its efforts on those tax issues most significant to taxpayers and the IRS.

The Office of Chief Counsel also needs to improve its processes for issuing published guidance more timely. Our sample of published guidance projects showed that only 22 percent of the projects were completed by the target date established at the beginning of the project. These projects were open for an average of 2.1 years (780 days) and ranged from being open 20 days to 15.5 years (5,644 days). In addition, the Office of Chief Counsel does not effectively measure the timeliness of the Published

¹ Published guidance includes regulations, revenue rulings, revenue procedures, and notices.

Guidance Program. The standard used to measure its performance is to complete projects by the end of the plan year, instead of completing projects by the established target dates. Without a meaningful process to monitor the timely issuance of guidance, the Office of Chief Counsel cannot meet the increasing demands placed upon the Published Guidance Program. Consequently, delays in issuing guidance make it difficult for taxpayers to comply with the tax laws and for the IRS to apply the tax laws in a correct and uniform manner.

We recommended that the Office of Chief Counsel implement a process that controls and documents the tax issues from receipt to disposition. This would include prioritizing tax issues based on their impact on taxpayers and/or tax administration. We also recommended that the Office of Chief Counsel implement performance measures that evaluate the timeliness of the Published Guidance Program and establish a process that assigns accountability over the circulation and review of proposed published guidance.

Management's Response: With regard to our first recommendation, the Office of Chief Counsel agreed that each Associate Chief Counsel would maintain files of tax issue requests and responses and would acknowledge to stakeholders the receipt of tax issue requests. However, the Office of Chief Counsel did not agree that other aspects of our recommendation would significantly advance the published guidance process. With regard to our second recommendation, the Office of Chief Counsel will consider incorporating into the manual the processes for setting and monitoring target dates and interim milestones and the processes for evaluating each Associate Chief Counsel based on the completed projects during the year. The Office of Chief Counsel will also study the feasibility of generating a single user-friendly report, which could be regularly updated to reflect new deadlines and projects. Management's complete response to the draft report is included as Appendix V.

Office of Audit Comment: Although the Office of Chief Counsel acknowledged the importance of selecting and prioritizing guidance initiatives and focusing limited resources on the most critical areas, it has only outlined limited actions to improve the process. The Office of Chief Counsel has not initiated steps to document the criteria for prioritizing and selecting projects. Formally documenting the criteria for selecting and prioritizing projects for the Guidance Priority List would provide assurances that the tax issues with the most significant impact on taxpayers and/or tax administration have been accepted. To effectively manage the Published Guidance Program for timeliness, the Office of Chief Counsel needs to take action to incorporate these processes into the manual and not merely consider them. In addition, these processes should be documented to assure implementation of these processes and to assign accountability for timely completion of the projects.

While we continue to believe that our recommendation has merit, we do not intend to elevate our disagreement concerning this recommendation to the Department of the Treasury for resolution.

Copies of this report are also being sent to the IRS managers who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or

Daniel R. Devlin, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs) at (202) 622-8500.

**Improvements to the Office of Chief Counsel’s Published Guidance Process Would
Enhance Guidance Provided to Taxpayers and the Internal Revenue Service**

Table of Contents

Background	Page 1
The Office of Chief Counsel Needs to Improve Processes for Prioritizing and Tracking Tax Issues Being Considered for the Published Guidance Plan	Page 3
<u>Recommendation 1:</u>	Page 5
The Office of Chief Counsel Needs to Improve Its Processes for Issuing Published Guidance More Timely	Page 6
<u>Recommendation 2:</u>	Page 10
Appendix I – Detailed Objectives, Scope, and Methodology	Page 13
Appendix II – Major Contributors to This Report.....	Page 15
Appendix III – Report Distribution List	Page 16
Appendix IV – List of Published Guidance Projects Reviewed	Page 17
Appendix V – Management’s Response to the Draft Report	Page 19

Improvements to the Office of Chief Counsel's Published Guidance Process Would Enhance Guidance Provided to Taxpayers and the Internal Revenue Service

Background

The Office of Chief Counsel is responsible for explaining and providing the correct legal interpretation of the internal revenue laws to its stakeholders. The Published Guidance Program is how the Internal Revenue Service (IRS) and the Department of the Treasury's Office of Tax Policy (OTP) prioritize the published guidance projects, which interpret and explain the Internal Revenue Code (I.R.C.). The Office of Chief Counsel uses published guidance as the means to promote a uniform understanding and consistent application of the tax laws by taxpayers and the IRS.

The Office of Chief Counsel and the Department of the Treasury's OTP are responsible for drafting and issuing published guidance. Published guidance consists of regulations, revenue rulings, revenue procedures, and notices, as defined below:

- Regulations – guidance for new legislation and to address issues that arise with respect to the existing I.R.C. sections (e.g., a court decision that invalidates part of a regulation, a new financial product, or an abusive transaction).
- Revenue Rulings – official interpretations of the I.R.C., related statutes, tax treaties, and regulations, as applied to a specific set of facts.
- Revenue Procedures – official statements of procedures that affect the rights or duties of taxpayers or other members of the public under the I.R.C., related statutes, tax treaties, and regulations.
- Notices – public pronouncements that may contain guidance that involve substantive interpretations of the I.R.C. or other provisions of the law.

The IRS' modernization effort brought about processing changes within the Office of Chief Counsel, including the formation of the Published Guidance Advisory Committee. The Committee is responsible for compiling its list of important projects in the Guidance Priority List (GPL). The GPL was designed to help ensure timely completion of published guidance projects and provides a mechanism for coordinating tax issues among the different business units of the IRS, the Office of Chief Counsel, and the Department of

Improvements to the Office of Chief Counsel's Published Guidance Process Would Enhance Guidance Provided to Taxpayers and the Internal Revenue Service

the Treasury's OTP. This process should result in a GPL that is comprehensive and responsive to taxpayer needs.

Each year, the IRS publishes a notice in the Internal Revenue Bulletin¹ soliciting public input on tax issues to be included in the GPL. The IRS also solicits input from the different functions within the Office of Chief Counsel and the IRS business units. The IRS and the Department of the Treasury's OTP use the information to identify and prioritize the tax issues needing clarification through regulations, rulings, and other published administrative guidance. Public input is considered an important part of the process for formulating the GPL to ensure that the IRS' resources focus on the tax issues that are most important to taxpayers and tax administration.

Annually, the IRS and the Department of the Treasury's OTP issue the GPL, identifying the projects targeted for publication during the plan year. For example, the 2001 GPL identified 299 projects targeted for completion by June 30, 2002.

Once the IRS and the Department of the Treasury's OTP approve the GPL, the tax issues are established on the Technical Management Information System (TECHMIS). The TECHMIS is an automated system designed to provide the Office of Chief Counsel managers with the tools necessary to work more efficiently and to control and monitor the progress of published guidance projects.

Upon assignment of a published guidance project, a project legal file is established to provide a record of actions taken and to support decisions made during the development of the guidance. Prior to publication, the proposed guidance is circulated for review and comment within and outside the Office of Chief Counsel.

The audit was performed in the Office of Chief Counsel in Washington, D.C., between January and September 2002. The audit was conducted in accordance with *Government Auditing Standards*. Detailed information of our audit

¹ The Internal Revenue Bulletin is the authoritative instrument of the IRS Commissioner for announcing official rulings and procedures.

Improvements to the Office of Chief Counsel's Published Guidance Process Would Enhance Guidance Provided to Taxpayers and the Internal Revenue Service

The Office of Chief Counsel Needs to Improve Processes for Prioritizing and Tracking Tax Issues Being Considered for the Published Guidance Plan

objectives, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

The Office of Chief Counsel does not document the process for prioritizing tax issues to be considered for the GPL. Since resources are limited within the Office of Chief Counsel, it needs to ensure that it is focusing its efforts on those tax issues most significant to taxpayers and the IRS. The Published Guidance Advisory Committee reviews suggestions and selects the tax issues to be included for the GPL. However, the Office of Chief Counsel does not record the criteria used by the Committee for selecting the tax issues for publication or document the expected impact of the selected tax issues on taxpayers or tax administration. We also did not find any evidence in the project files or on the TECHMIS indicating the Committee's basis for selecting a tax issue as a published guidance project.

In addition, the Office of Chief Counsel did not have a process for tracking either suggestions that were not selected or the Committee's basis for excluding the tax issues in the yearly plan. While about half of the groups in the Office of Chief Counsel maintained a file of suggestions, these suggestions and their impact on taxpayers and tax administration were not centrally maintained for consideration as future published guidance projects.

The Office of Chief Counsel at times needs to address new tax issues after the GPL has been approved. When addressing these tax issues, the Office of Chief Counsel does not have a process to determine the impact the new projects will have on the completion of projects already listed on the GPL. For example, in FY 2001, the Office of Chief Counsel's technical functions added six projects to the GPL after it was approved. However, these additional projects did not include a justification showing why these projects were a higher priority than other scheduled projects.

Although the Committee had not documented the criteria or the basis for selecting the tax issues, Committee members advised us that published guidance projects were selected when the tax issues:

Improvements to the Office of Chief Counsel's Published Guidance Process Would Enhance Guidance Provided to Taxpayers and the Internal Revenue Service

- Affected a significant number of taxpayers.
- Had a significant impact upon revenue.
- Required a revision of the IRS' position or procedure as articulated in a published product.

Since the Committee did not keep records on the basis for selecting individual projects, we were unable to determine whether the projects aligned with these criteria.

We believe that formally tracking this process would benefit the Office of Chief Counsel through enhanced accountability over the process. Formally documenting the criteria for selecting projects and retaining a record of the disposition of each suggested project will provide some assurance that only the tax issues with the most significant impact on taxpayers and/or tax administration have been accepted for consideration. The existing process does not sufficiently provide the Office of Chief Counsel with this assurance.

An enhanced tracking process would also give the Office of Chief Counsel the ability to provide feedback to customers on the disposition of their suggested tax issues. We believe that initiators of requests for guidance should be informed whether the Office of Chief Counsel will pursue their concerns and when they may expect a response. Alternatively, requesters should be informed when their tax matters will not be pursued so that they may undertake a different course of action.

Finally, centrally tracking requests for guidance and the related dispositions holds forth the opportunity to collect valuable management information. With it, the Office of Chief Counsel may identify and monitor such matters as:

- Collective impact of published guidance projects on taxpayers and the IRS.
- Incremental return from applying additional resources to GPL projects.
- Recurring concerns that come forth over time.

Improvements to the Office of Chief Counsel's Published Guidance Process Would Enhance Guidance Provided to Taxpayers and the Internal Revenue Service

- Cross cutting matters that affect several IRS business units, types of taxpayers, or other stakeholders.
- Implications for the IRS' business units that result from unresolved tax matters.

It is noteworthy that during the 2000 GPL plan year, the Office of Chief Counsel created a database to control suggestions and provide informative descriptions including the potential impact of the tax issues. However, the Office of Chief Counsel did not update the database to reflect the impacts or dispositions of tax issue suggestions or continue to use the database in subsequent plan years, because it was time consuming to maintain.

Recommendation

1. The Office of Chief Counsel should implement a process that controls and documents tax issues from receipt to disposition. This process should include:
 - Formally documenting the criteria for selecting projects.
 - Standardizing the format for incoming requests to include information relative to the criteria to facilitate review for inclusion on the GPL.
 - Picking the projects that best meet the criteria and maintaining a record of the disposition.
 - Keeping a record of who requested the project so that the Office of Chief Counsel staff may follow up with the requester.
 - Providing feedback to those whose projects were accepted telling them when to expect a response, and to those whose tax issues were not selected telling them the reason for non-selection.
 - Publishing and circulating the GPL to show the benefits and impact of the plan.

Improvements to the Office of Chief Counsel's Published Guidance Process Would Enhance Guidance Provided to Taxpayers and the Internal Revenue Service

- Tracking the requested projects and evaluating the usefulness of this information to the IRS, taxpayers, and other stakeholders.

Management's Response: The Office of Chief Counsel agreed that each Associate Chief Counsel would maintain files of tax issue requests and the responses to these requests. Management also agreed to provide, as a courtesy, written acknowledgment to stakeholders of the receipt of tax issue requests. The Office of Chief Counsel did not believe that the remainder of the recommendation would significantly advance the published guidance process and would more likely result in burdens that exceed expected benefits.

Office of Audit Comment: Although the Office of Chief Counsel acknowledged the importance of selecting and prioritizing guidance initiatives and focusing limited resources on the most critical areas, they have only outlined limited actions to improve the process.

The Office of Chief Counsel has taken steps to reevaluate the GPL on a quarterly basis, adding projects throughout the year rather than on an annual basis. However, the Office of Chief Counsel has not initiated any steps to document the criteria for prioritizing and selecting projects. Documenting the criteria for prioritizing projects would allow stakeholders to focus published guidance requests and would provide the Published Guidance Advisory Committee the opportunity to weigh additional quantitative data, such as revenue impact or taxpayer burden, when considering proposed projects. Finally, formally documenting the criteria for selecting and prioritizing projects for the GPL would provide assurances that the tax issues with the most significant impact on taxpayers and/or tax administration have been accepted.

The Office of Chief Counsel Needs to Improve Its Processes for Issuing Published Guidance More Timely

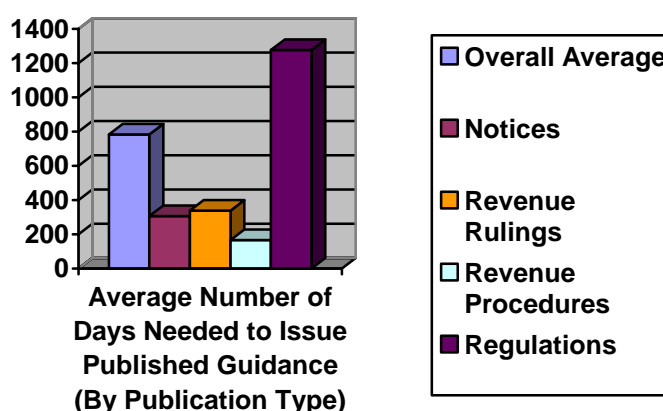
The Office of Chief Counsel needs to improve its monitoring process to assure that projects are issued more timely. Our sample of the published guidance projects randomly selected from the 2001 GPL showed that only 7 (22 percent) of 32 of the published guidance projects were completed by the target date established at the beginning of the project. These projects were open, on average, for more

Improvements to the Office of Chief Counsel's Published Guidance Process Would Enhance Guidance Provided to Taxpayers and the Internal Revenue Service

than 2.1 years (780 days) and ranged from being open 20 days to 15.5 years (5,644 days).²

The amount of time used to complete the published guidance projects was largely dependent upon the type of guidance issued. For example, revenue rulings took an average of 339 days to complete, while regulations took an average of 3.5 years (1,276 days) to complete. The graph below depicts the average number of days it took the Office of Chief Counsel to issue the various types of published guidance for our sample of projects.

Timeliness of Published Guidance



Source: The TECHMIS.

Although projects are planned for completion during the GPL plan year, our sample of published guidance included projects that have been open for years. For example, 1 project had been open for 4.2 years (1,517 days) at the time of our review. The project was initiated to provide guidance on the constructive sale treatment for appreciated financial positions under I.R.C. § 1259. However, we could not assess the impact to either the taxpayer or the IRS caused by the lengthy time to complete the project. This was because the IRS had no record of who requested the guidance and, as a result, we were unable to

² The number of days to issue published guidance was computed by determining the number days from initial assignment of the project to an attorney and/or reviewer to the date of publication.

Improvements to the Office of Chief Counsel's Published Guidance Process Would Enhance Guidance Provided to Taxpayers and the Internal Revenue Service

contact the requester. Further, the IRS did not maintain sufficient information to assess the impact of not timely completing the project.

Another sampled project was initiated to provide guidance on United States taxpayers who transfer property to foreign trusts under I.R.C. § 679. Guidance for this project was issued in July 2001 after it had been open for 12.3 years (4,502 days). Again, we could not identify the requesting party nor could we identify any evidence in the project legal file or the management information system to show the impact of having this project open for over 12 years.

In many instances, delays in issuing published guidance occur because organizations outside the Office of Chief Counsel, including the Department of the Treasury's OTP and other IRS business units, are required to review the guidance before it can be issued. In one project, the Department of the Treasury's OTP had proposed guidance for 2 years prior to returning it without comment or concurrence.

A more structured process for circulating and reviewing proposed published guidance is needed to establish accountability for completing the reviews within reasonable time periods. Since the Office of Chief Counsel has primary responsibility for producing the published guidance, it is in the best position to establish reasonable time periods for reviewing guidance internally and for working with other organizations to establish accountability standards, which would assist in ensuring that projects are completed by the established target dates.

In addition, delays occur because the Office of Chief Counsel does not effectively manage the timeliness of the Published Guidance Program. The standard used to measure its performance is to complete projects by the end of the GPL plan year instead of completing projects by the established target dates. Projects that are not completed during the GPL plan year are carried over to the following GPL plan year and new target dates are established. As a result, the target dates are meaningless and are not a concern to those responsible for issuing published guidance.

Improvements to the Office of Chief Counsel's Published Guidance Process Would Enhance Guidance Provided to Taxpayers and the Internal Revenue Service

Between 1992 and 2000, the Office of Chief Counsel reported completing 64 percent of its published guidance projects by the end of the plan year, on average. Since approximately one-third of the projects were carried over from previous GPL plan years and new target dates were established, the reported timeliness was overstated.

Managers in the Office of Chief Counsel used management information system reports to track the due date of the next action required for a project. The managers also periodically met with the assigned attorneys to monitor the progress of projects.

If the Office of Chief Counsel is going to effectively manage for timeliness, it will need to track the original date targeted for completion and establish better accountability standards for completing projects. One standard should require managerial approval when additional time is needed to complete a project. This would provide management the tools necessary to monitor and track the timely completion of projects. This process should also include the use of milestones and interim target dates, and the establishment of standards throughout the review process to create accountability for completing projects within reasonable time periods.

Without an effective process to monitor the timely issuance of published guidance, the Office of Chief Counsel cannot meet the increasing demands placed upon the Published Guidance Program, making it difficult for taxpayers to comply with the tax laws and the IRS to apply the tax laws in a correct and uniform manner.

As previously indicated, we attempted to assess the implications of these delays but were unable to do so. The Office of Chief Counsel did not maintain sufficient documentation to determine the impact that delays in completing published guidance projects had on its customers. It had no empirical information to quantify the numbers of taxpayers or stakeholders affected or the dollars involved, with respect to particular guidance projects. However, taxpayers affected by the published guidance, IRS employees who administer the tax laws, and tax professionals who advise and assist taxpayers are all

Improvements to the Office of Chief Counsel's Published Guidance Process Would Enhance Guidance Provided to Taxpayers and the Internal Revenue Service

impacted by the untimely completion of published guidance projects.

When we inquired, the Office of Chief Counsel stated that it could not quantify the impact delays had on the customers in the projects we sampled. It stated that even though published guidance projects are selected based on the number of taxpayers affected, the amount of revenue affected, or a revision of the IRS' position, the Office of Chief Counsel does not require legal project files or its management information system to show the impact of delays on its customers. Also, decisions for issuing published guidance are typically based upon its knowledge of the tax issue involved and, when available, upon the information provided by IRS functions, taxpayers, tax practitioner groups, and others who have suggested the need for guidance.

The Chief Counsel is aware of the delays in issuing published guidance. In an article from the March-April 2002 edition of *The Tax Executive*, the Chief Counsel expressed his concerns over the amount of time that it was taking to complete published guidance projects and the impact these delays have on tax administration. He believes that the IRS has a public duty to provide timely guidance to taxpayers who are trying to comply with the law. To accomplish this, the Office of Chief Counsel will attempt to issue guidance that addresses the major issues as soon as possible so that the public and the field are aware of the position of the agency.

Recommendation

2. The Office of Chief Counsel should improve its process for issuing published guidance within established time periods by:
 - Implementing performance measures which evaluate the timeliness of the Published Guidance Program. This can be accomplished by setting time standards throughout the review process, using milestones and target dates to monitor progress in regard to overall timeliness, and ensuring that project activity is

Improvements to the Office of Chief Counsel's Published Guidance Process Would Enhance Guidance Provided to Taxpayers and the Internal Revenue Service

appropriately documented in project legal files and/or management information systems.

- Establishing a process that assigns accountability over the circulation and review of proposed published guidance and for resolving the delays in this process. The process should include standard time periods for circulating and reviewing projects within the Office of Chief Counsel. The Office of Chief Counsel should also work with other organizations, such as the Department of the Treasury's OTP and the IRS' business units, in establishing expectations for completing their reviews of the proposed published guidance and operational procedures to intercede when excessive delays occur in the review process.

Management's Response: The Office of Chief Counsel will consider incorporating into the manual the processes for setting and monitoring target dates and interim milestones and the processes for evaluating each Associate Chief Counsel based on the number, quality, and difficulty of the completed projects during the year. The Office of Chief Counsel will also study the feasibility of generating a single user-friendly report, which could be regularly updated to reflect new deadlines and projects.

The Office of Chief Counsel and the Department of Treasury's OTP agreed to implement an expedited guidance process to reduce delays after the period covered by the TIGTA report. The expedited guidance process was designed to reduce the amount of review time spent by the Department of the Treasury's OTP on projects with no significant tax policy issues.

Office of Audit Comment: To effectively manage the timeliness of the Published Guidance Program, the Office of Chief Counsel needs to take action to incorporate these processes into the manual and not merely consider them. In addition, these processes should be documented to help assure their implementation and to assign accountability for timely completion of the projects.

Improvements to the Office of Chief Counsel's Published Guidance Process Would Enhance Guidance Provided to Taxpayers and the Internal Revenue Service

Although the expedited guidance process addressed review time in the Department of Treasury's OTP, the Office of Chief Counsel has not yet initiated actions to resolve delays within the Office of Chief Counsel itself. Implementing procedures within the Office of Chief Counsel as we have recommended will assign accountability for the circulation and review of proposed published guidance.

Detailed Objectives, Scope, and Methodology

The overall objectives of this audit were to determine whether the Office of Chief Counsel's published guidance process effectively prioritizes tax issues and management effectively monitors published guidance projects to provide the Internal Revenue Service (IRS) and taxpayers with timely guidance. To accomplish our audit objectives, we performed the following audit tests:

- I. Interviewed six Associate Chief Counsel personnel, reviewed supporting documentation, and determined whether the Office of Chief Counsel effectively prioritized tax issues to be considered for published guidance projects.
 - A. Reviewed the inventory listings from the Associate Chief Counsel's technical units that identifies the tax issues for potential projects and determined the disposition of the tax issues.
 - B. Reviewed the 2001 Guidance Priority List (GPL) and:
 - 1. Determined the criteria used to prioritize tax administration issues and decide what order the published guidance projects were to be worked.
 - 2. Evaluated the level of input the Office of Chief Counsel had to determine the priority to which published guidance projects were included in the GPL.
 - 3. Determined how adjustments were made to the GPL when the IRS and the Department of the Treasury's Office of Tax Policy had to respond to developments that occurred during the year.
- II. Interviewed a total of 10 Associate Chief Counsel technical unit managers and attorneys, and reviewed a sample of opened and closed published guidance project legal files from the Technical Management Information System 2001 GPL report to evaluate management's controls for tracking and monitoring the published guidance projects.
 - A. Determined whether initiated published guidance projects were coordinated to avoid duplication of similar tax issues being addressed by other projects.
 - B. Reviewed management information reports used to monitor the status of published guidance projects and determined whether target completion dates were established to ensure the guidance was issued timely.

Improvements to the Office of Chief Counsel's Published Guidance Process Would Enhance Guidance Provided to Taxpayers and the Internal Revenue Service

- C. Determined whether project legal files were reviewed to ensure that they contained all required documentation and that discrepancies were annotated.
 - D. Determined whether controls were established to ensure dissenting opinions were addressed, considered, and documented.
 - E. Determined whether confidentiality procedures were established and followed.
 - F. Determined how all "interested parties"¹ were identified to ensure their comments and suggestions were incorporated into the final published products.
 - G. Assessed the impact of tax administration issues not timely published.
 - H. Determined whether published guidance projects were properly reviewed and approved.
 - I. Reviewed published guidance projects to ensure they met Federal Register² and Internal Revenue Bulletin³ publication requirements.
- III. Evaluated the Office of Chief Counsel's initiatives to improve the published guidance process and assessed the impact of each initiative.

¹ Interested parties may include the Congress, taxpayers affected by the published guidance, employees of the IRS responsible for administering the tax laws, Department of the Treasury officials, and tax professionals who advise and assist taxpayers.

² The Federal Register is the publication of the Code of Federal Regulations by the Executive departments and agencies of the Federal Government.

³ The Internal Revenue Bulletin is the authoritative instrument of the IRS Commissioner for announcing official rulings and procedures of the IRS.

Major Contributors to This Report

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**Improvements to the Office of Chief Counsel's Published Guidance Process Would
Enhance Guidance Provided to Taxpayers and the Internal Revenue Service**

Appendix III

Report Distribution List

Acting Commissioner N:C
Deputy Chief Counsel (Technical) CC
National Taxpayer Advocate TA
Director, Office of Program Evaluation and Risk Analysis N:ADC:R:O
Director, Legislative Affairs CL:LA
Office of Management Controls N:CFO:F:M
Audit Liaison: Chief Counsel CC

Improvements to the Office of Chief Counsel's Published Guidance Process Would Enhance Guidance Provided to Taxpayers and the Internal Revenue Service

Appendix IV

List of Published Guidance Projects Reviewed

Project Description	Date Assigned	Publication Date	Original Target Date	Days Open¹
Employee Stock Options and Restricted Stock in Section 355 Transactions	2/2/2000	1/14/2002	Unknown	712
Taxable Asset Acquisitions and Dispositions of Insurance Companies	10/3/2000	3/8/2002	Unknown	521
Clarification of Section 1.1502-80	7/24/2001	11/14/2001	8/30/2001	113
Alternative Agents of Consolidated Group	2/18/1999	In Progress	Unknown	1,132
Section 368: Mergers of a Corporation With a Disregarded Entity	5/15/2001	11/15/2001	8/30/2001	184
Guidance Under Section 355(e)	4/5/2000	8/3/2001	7/30/2001	485
Stock Basis Adjustments	8/7/2001	In Progress	10/30/2001	231
Section 1259: Constructive Sales Treatment For Appreciated Financial Positions	1/29/1998	In Progress	Unknown	1,517
Conformity Election for Banks Under Section 1.166-(2)(D)(3)	5/4/2001	12/17/2001	Unknown	227
Securities Futures Contracts	7/25/2001	2/19/2002	8/1/2001	209
Section 471: Unit Livestock Price Method of Accounting	5/9/2001	2/4/2002	11/30/2001	271
Section 446 and 471: Cash Method of Accounting	12/12/1997	12/26/2001	Unknown	1,475

¹ Days Open were computed by determining the number of days from the Date Assigned to Publication Date or our sample date of March 26, 2002.

Improvements to the Office of Chief Counsel's Published Guidance Process Would Enhance Guidance Provided to Taxpayers and the Internal Revenue Service

Project Description	Date Assigned	Publication Date	Original Target Date	Days Open
Accounting Period Regulations	4/9/1999	In Progress	Unknown	1,082
Update of Revenue Procedure 87-32	5/15/2001	6/4/2001	5/1/2001	20
Section 162 and 263: Reduction and Capitalization of Expenditures	5/9/2001	1/24/2002	9/30/2001	260
Competent Authority Procedure – Update of Revenue Procedure 96-13	4/14/2000	In Progress	Unknown	711
Nonqualified Intermediaries Notice	5/1/2001	7/23/2001	6/30/2001	83
Extraterritorial Income Exclusion Elections	10/19/2000	6/4/2001	Unknown	228
Revenue Ruling 2001-39	3/24/2000	8/13/2001	Unknown	507
Modification to Section 367(a) Stock Transfer Regulations	10/6/1999	In Progress	Unknown	901
Clarification of Entity Classification Rules	1/21/2000	In Progress	Unknown	795
Taxation of Global Trading	8/21/1990	In Progress	Unknown	4,235
Amendment to Revenue Procedure 96-14	9/28/2001	In Progress	9/30/2001	179
Foreign Grantor Trusts	3/23/1989	7/20/2001	Unknown	4,502
Allocation of Loss on Dispositions of Personal Property	3/17/1998	12/28/2001	Unknown	1,382
Reciprocal Exemptions for Certain Transportation Income	10/12/1986	In Progress	Unknown	5,644
Modification of Revenue Ruling 97-31	2/8/2001	10/15/2001	7/31/2001	249

Improvements to the Office of Chief Counsel's Published Guidance Process Would Enhance Guidance Provided to Taxpayers and the Internal Revenue Service

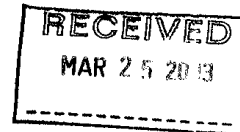
Appendix V

Management's Response to the Draft Report




DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

March 21, 2003



MEMORANDUM FOR TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

FROM: B. John Williams, Jr. 
Chief Counsel, Internal Revenue Service

SUBJECT: Management Response to Audit Report # 200210005 --
Improvements to the Office of Chief Counsel's Published
Guidance Process Would Enhance Guidance Provided to
Taxpayers and the Internal Revenue Service

As I reviewed your draft report, I was pleased that you recognize the importance of selecting and prioritizing published guidance initiatives, focusing our limited resources on the most critical areas, and using processes that will enable us to publish more guidance more quickly. A strong published guidance program will instill confidence in the fairness of our tax system and ensure that the Service is enforcing the rules consistently and impartially.

The Office of Chief Counsel has various processes for its published guidance goals. These include regular and ongoing solicitation of ideas from both internal and external stakeholders through various forums. Guidance projects are selected by senior managers and executives in both Counsel and Treasury who are experts in the subject matter after consultation with stakeholders. The guidance projects are managed and monitored through regular reports and meetings, the setting and reevaluation of deadlines, quarterly updates to the guidance plan, and performance evaluations. Delays are resolved through weekly joint briefings, use of the expedited guidance program, and active hands-on involvement by senior managers and executives.

Your report raises some concerns that certain processes undertaken by Counsel are not sufficiently documented, and that a better automated system is necessary to more efficiently control and monitor the progress of guidance projects. I agree that certain improvements could be made to enhance the published guidance program. I have attached a detailed response outlining the corrective actions that the Office of Chief Counsel will take to address your recommendations.

Attachment

Improvements to the Office of Chief Counsel's Published Guidance Process Would Enhance Guidance Provided to Taxpayers and the Internal Revenue Service

Attachment

Response to TIGTA Number 200210005

Recommendation 1

The Office of Chief Counsel should implement a process that controls and documents tax issues from receipt to disposition. This process should include (i) a process for tracking and documenting each publication suggestion received by Counsel, from its original receipt to its ultimate disposition (*i.e.*, publication or decision against publication); (ii) documentation of criteria used by the Published Guidance Advisory Committee (PGAC) to consider tax issues for published guidance and their listing on the Guidance Priority List (GPL); (iii) publication of the expected impact of the selected tax issues on taxpayers or tax administration; and (iv) a process for responding to those stakeholders who provide suggested tax issues for published guidance of either the decision to publish and the expected publication date, or the decision not to publish and the reasons why.

Assessment of Cause

Counsel does not (i) document the process for prioritizing tax issues, (ii) document the criteria for selecting tax issues for publication, (iii) document the impact of selected tax issues on taxpayers or tax administration, or (iv) provide feedback to persons requesting guidance. As a result, according to TIGTA, Counsel is not ensuring that its efforts are focused on those tax issues most significant to taxpayers and the IRS.

Corrective Action

Counsel agrees with TIGTA's emphasis on the importance of selecting and prioritizing guidance initiatives, and focusing limited resources on the most critical areas. Counsel's process for achieving these goals includes (i) the regular and ongoing solicitation of ideas for published guidance from the Operating Divisions of the IRS as well as taxpayers (and their representatives), through a variety of forums, including meetings, bar association and other conferences, and written communications; (ii) the significant review of the need and feasibility of the guidance proposal by senior managers and executives in both Counsel and the Office of Tax Policy (OTP) who are subject matter experts in the area of the proposal; and (iii) weekly joint briefings of the Chief Counsel and the Assistant Secretary of Tax Policy. This process applies not only to the items listed on the original GPL, but also to various new priorities adopted during the guidance year which inherently will affect the feasibility or timing of projects listed on the original GPL.

The TIGTA Report raises some issues and concerns that Counsel will address in part. For example, while Counsel does not support the maintenance of an office-wide database that will track all the requests for guidance, Counsel does believe that each

Improvements to the Office of Chief Counsel's Published Guidance Process Would Enhance Guidance Provided to Taxpayers and the Internal Revenue Service

Associate office should maintain organized files of these requests and our responses to these requests. In addition, while we do not support the preparation of written notifications to all stakeholders who have requested published guidance of our decision to publish or not, we do believe that Counsel should, at a minimum as a courtesy, provide written acknowledgment to the stakeholder of our receipt of the requested guidance and our assurance that we will give it due consideration.

For the reasons explained below, Counsel does not believe that the remainder of Recommendation 1 will significantly advance the published guidance process and, more likely, will result in burdens that exceed the expected benefits. While Counsel agrees with TIGTA that Counsel needs to focus its limited resources on those projects that will provide the greatest benefit to the tax system, Counsel believes that its current practice of maintaining close working relationships and open lines of communication with its stakeholders better achieves that goal than would the approach suggested by TIGTA.

(i) Process for Tracking Publication Suggestions

As the TIGTA Report notes on page 5, Chief Counsel did establish a comprehensive database when the PGAC was first formed. The database was designed to do exactly what TIGTA recommends, namely (i) track each project recommended for the business plan and record why each suggestion was either accepted or rejected for publication, (ii) develop objective criteria that explain how projects were selected, and (iii) notify both internal and external stakeholders of the disposition of the project. The database, originally designed, was intended to facilitate the reexamination of the rejected requests in later years for possible publication as additional resources were available. The database, however, required considerable time and effort on the part of Counsel staff to input all of the requests, and to identify the requesting party and the issue.

Despite this exhaustive process, the database proved to be labor intensive and of limited value. Counsel did not find it useful to reexamine rejected projects in later years to identify candidates for the next business plan cycle. Stakeholders' priorities shift from year to year, in part because of new legislation or changes to the Operating Division's initiatives. Counsel deliberately casts a broad net in soliciting ideas, since we would rather collect a number of impractical ideas rather than miss one good one. As a result, the database necessarily included many unrefined or even obsolete proposals. It also did not capture the diverse pressures that needed to be balanced in prioritizing guidance. We generally rely instead on the annual and ongoing business plan development processes to identify those issues having continuing importance in the current year. This determination could not be made using the archived information. This is not to say that each Associate office should not keep a record of suggestions or projects that we do not include in a given year so that they may be reconsidered. This is already done by some Associate offices, but should be adopted as a best practice by all to follow.

Improvements to the Office of Chief Counsel's Published Guidance Process Would Enhance Guidance Provided to Taxpayers and the Internal Revenue Service

In addition, the database was not useful in developing or applying any type of documented or objective criteria in determining how projects were selected. Instead notwithstanding the availability of the database, guidance projects were -- and are -- selected based on Counsel's and OTP's determination of their importance to tax administration and the amount of resources that Counsel and OTP would each be required to invest in the project.

(ii) Documentation of Criteria for Selecting Published Guidance

Counsel questions whether it would be productive to develop and administer objective criteria in an elastic, inherently subjective process that depends on the individual expertise and judgment of the executives and senior managers. Counsel regularly consults or meets with OTP and each of the Operating Divisions and their counsel in developing the GPL and in assessing additional projects requested during the course of the year in trying to determine -- based on its discussions with the affected constituencies -- the importance of the project in relation to our other pending or proposed projects and our current resource availability. The selection of projects is ultimately made by executives who are in the best position to make those decisions. Considerations include the importance of the project to the Service's implementation of a program or the need to correct a compliance problem. It is critical that these executives be given sufficient flexibility to allow for management discretion in their decision-making.

(iii) Publication of Expected Impact of Published Guidance

Counsel is often not in a position to publish quantitative data on the prospective revenue impact of proposed guidance projects or to quantify potential reductions in taxpayer burden or the demands on Service resources that could result from a particular project. These issues are considered and weighed during the GPL selection process, in cases where the relevant information is presented to Counsel and can be verified. When a final regulation is published, however, the preamble contains information concerning the impact on taxpayers and tax administration. In particular, the paperwork burden is explained, as required by law.

(iv) Responding to Stakeholders Requesting Published Guidance

Counsel does follow up with many stakeholders who have requested published guidance. Requests made by Operating Divisions generally are brought to the Associate offices through the Division Counsels. Decisions made with respect to such requests are communicated by each Associate office directly to Division Counsel, and then by Division Counsel to the Operating Division. By filtering the Operating Divisions' requests through Division Counsel, the process remains manageable for the Associate office, allows the Operating Division (through its Division Counsel) to have a direct role

Improvements to the Office of Chief Counsel's Published Guidance Process Would Enhance Guidance Provided to Taxpayers and the Internal Revenue Service

in deciding those projects to be pursued, and allows Counsel to provide immediate feedback regarding those projects accepted or rejected. The existence of a database, documented/objective selection criteria, or a formalized feedback mechanism would not significantly improve this system of personal interaction.

Each Associate office also provides similar feedback to our primary external stakeholders, such as the AICPA, TEI, and the ABA, and other large groups of taxpayers and taxpayer representatives. Due to our resource limitations, however, we do not believe that responding personally to each external suggestion would be the best use of our very limited resources. It is axiomatic that the time required to implement the procedural and administrative requirements sought by TIGTA would directly reduce the time available to us in actually developing guidance.

Responsible Officials and Implementation Dates

With respect to the maintenance of organized files of requests for guidance and our responses to these requests:

Responsible Official: Each Associate Chief Counsel with jurisdiction over subject matter

Implementation Date: June 1, 2003

With respect to the practice of providing written acknowledgments to all stakeholders of our receipt of the requested guidance and our assurance that we will give it due consideration:

Responsible Official: Each Associate Chief Counsel with jurisdiction over subject matter

Implementation Date: June 1, 2003

Recommendation 2

Counsel should improve its process for issuing published guidance within established time frames by (i) using milestones and target dates to monitor progress of guidance project and evaluate timeliness; (ii) appropriately documenting project activity in project legal files and/or management information systems; and (iii) resolving delays in review process through operational procedures.

Improvements to the Office of Chief Counsel's Published Guidance Process Would Enhance Guidance Provided to Taxpayers and the Internal Revenue Service

Assessment of Cause

According to TIGTA, Counsel does not have a meaningful process to monitor the timely issuance of guidance and, as a result, cannot meet the increasing demands of the published guidance program.

Corrective Action

Counsel agrees with TIGTA that we should adopt whatever processes that will enable us to publish more guidance more quickly. Counsel will continue its processes of (i) setting target publication dates for the guidance year at the beginning of the year in connection with developing the original GPL; (ii) monitoring the status of each GPL project and expected publication date with each Associate office and OTP through monthly reports and meetings, and making revisions as necessary to address competing priorities and unanticipated issues; (iii) evaluating Associates and their managers on the basis of the number, quality and difficulty of the guidance projects completed during the guidance plan year as well as their ability to meet critical deadlines and contribute to the quarterly updates to the GPL; and (iv) resolving delays through weekly joint briefings and use of the expedited guidance program.

Currently, setting target dates and monitoring the status of projects are done through reports generated from TECHMIS and various self-generated reports. The TECHMIS-generated reports do not contain all the information necessary to properly monitor the status of projects, and are not user-friendly. The various self-generated reports are time-consuming to prepare. Counsel believes that the published guidance process would be enhanced if all the information necessary to properly monitor the status of all of Counsel's projects is contained in a single, user-friendly report, which easily could be regularly updated to reflect new deadlines and projects. The appropriate personnel in Counsel will be directed to study the feasibility of generating such a report from TECHMIS or a new program, and to make recommendations to the Chief Counsel.

Counsel does object, however, to TIGTA's apparent assumption that, since the various processes are not in writing, they do not exist and, therefore, published guidance is not being managed effectively. Nevertheless, Counsel will consider incorporating these processes into the Chief Counsel Directives Manual, which is currently being redrafted.

(i) Using Milestones and Target Dates to Monitor Progress

Counsel agrees that interim "milestone" goals help identify whether projects are on pace to be issued by their target publication dates. Interim goals are a basic management tool that we already use. Interim milestones are not, however, used as an inflexible deadline for the purpose of holding any Associate office accountable. Milestones are changed for a variety of reasons inherent in the guidance process.

Improvements to the Office of Chief Counsel's Published Guidance Process Would Enhance Guidance Provided to Taxpayers and the Internal Revenue Service

Shifts in priorities may occur either in Counsel or at OTP, such as guidance required following the September 11 attacks, or guidance in response to new legislation. Projects may become more technically challenging than originally expected and require more research, analysis, and executive briefings to resolve policy calls before meaningful drafting can begin. Obviously, it is difficult to anticipate a variety of other delays inherent in a collaborative process that involves the participation of OTP, the Operating Divisions and Counsel.

Counsel and OTP set target publication dates for each project at the beginning of the year in connection with developing the original GPL. These dates are staggered throughout the year to reflect the relative priorities of the projects as well as resource allocation issues. Counsel and OTP monitor the status and target publication date of each GPL project with each Associate office through monthly reports and meetings. Revisions are made to target publication dates as necessary to address competing priorities and unanticipated issues, but only with the approval of the Deputy Chief Counsel. Counsel evaluates Associates and their managers on the basis of the number and quality of the guidance projects completed during the guidance plan year. Counsel agrees that it is important for the Associate offices to meet the target publication dates of the individual projects, and often these dates become critical deadlines (e.g., temporary regulations are about to expire, taxpayers need guidance before a filing date). In general, however, the annual measurement is a more complete reflection of the relative success of the Associate office in publishing guidance. Given the volume of expected guidance listed on the original GPL and quarterly updates, an Associate office will not be successful on an annual basis unless it is able to successfully manage the staggered target publication dates.

After the period covered by the TIGTA Report, Counsel instituted steps to make the GPL an ongoing process rather than simply an annual process. Counsel and OTP are now reevaluating the GPL on a quarterly basis. Instead of there being only a list of projects that Counsel and OTP select at the beginning of the year, new projects will be added throughout the year based on the needs of the Service and outside stakeholders for published guidance.

(ii) Documenting Project Activity in Legal Files and/or Management Information Systems

We agree that TECHMIS is not an efficient way to manage our projects. A TECHMIS number is established for a project when there is agreement to go forward, even though the project has an expected target date months later. For regulations, the same TECHMIS number remains associated with the project until final regulations are issued. In the interim, one or more sets of proposed or temporary regulations could be issued, but the project will not be regarded as completed according to TECHMIS. If, at the time a project is selected for the GPL, it is not known which form the guidance should take, a TECHMIS number is assigned. As the project advances, the form for the guidance is

Improvements to the Office of Chief Counsel's Published Guidance Process Would Enhance Guidance Provided to Taxpayers and the Internal Revenue Service

determined and a new TECHMIS number is assigned to the project. Thus, TECHMIS statistics do not accurately represent the amount of time actually spent in developing projects or the progress made. Nor is TECHMIS capable of generating an overage report for the main guidance projects. For these reasons, as well as a general desire to incorporate the reports for each Associate office into a single, user-friendly report, Counsel will explore the creation of a more functional report from either the TECHMIS system or a new system.

(iii) Resolving Delays in Review Process through Operational Procedures

After the period covered by the TIGTA Report, Counsel and OTP agreed upon and implemented a new process to reduce the amount of review time spent by OTP attorneys on certain types of guidance. This expedited guidance process will involve projects with no significant tax policy issues, so as not to diminish Treasury's policy review. Nor will it change the practice of having every regulation, revenue ruling, revenue procedure, and notice approved by the Chief Counsel and the Assistant Secretary (Tax Policy). This process, through deadlines and procedures for relatively quick approval, is intended to facilitate the ability of Counsel attorneys to produce more revenue rulings, revenue procedures, and "bullet" regulations with confidence that they will be published despite the more limited number of Treasury attorneys available to review these guidance projects.

Responsible Officials and Implementation Dates

With respect to studying the feasibility of generating a single, user-friendly report designed to help monitor the status of all of Counsel's projects, and making recommendations to the Chief Counsel:

Responsible Official: Associate Chief Counsel (Finance and Management)
Implementation Date: July 1, 2003

With respect to incorporating Counsel's processes for issuing published guidance into the Chief Counsel Directives Manual:

Responsible Official: Associate Chief Counsel (Procedure and Administration)
Implementation Date: August 1, 2003